Unit-5 Business Finance

1. Introduction

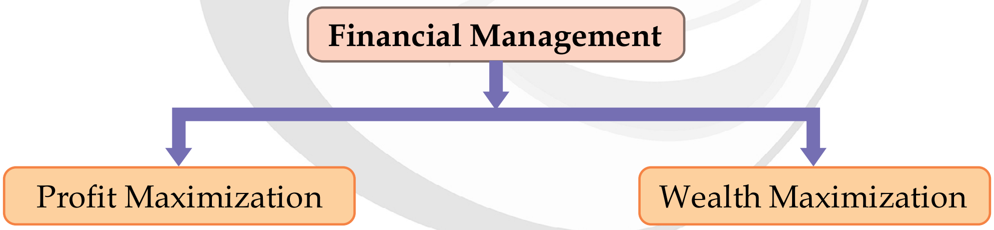
Finance is the life blood of a business. It is important for the industries and commerce. *Finance is needed for establishing, developing and operating of business activity. Without finance business cannot run successfully.*

Financial management is the combination of two words - Financial and management. **Financial** means procuring sources of money supply and allocation of these sources on the basis of forecasting. Monterey requirements of the business and **Management** refers to planning, organization, direction and control process of finance function.

> *According to* ***Wheeler A.H.*** *"Financial Management is that activity which is concerned with the acquisition and administration of capital funds in meeting the financial needs and overall objectivities of the business enterprises".*
> ***Solomon Ezra*** *define "Financial management is concerned with the efficient use of an important economic resource, namely capital fund"*

Financial Management is the **planning, organizing, directing and controlling** of the procurement and utilization of fund and it relates mainly with the control of performance, acquisition of funds, profitable use of these funds, planning for future activities and use suitable method such as financial accounting, cost accounting, budgeting, statistics etc.

Objectives of Financial Management



Profit Maximization : *The basic objective of the organization 'increase the profit' should be undertaken and decrease profits are avoided. It is traditionally economic theory.* A firm's performance is evaluated in terms of profitability. Allocation of resources and investors perception of the company's performance can be traced by profit maximization.

It is criticized on the following ground :

- *The objective of profit maximization is vague and narrow.*
- *It ignores risk factor as well as timing of returns.*
- *It emphasizes the short - run profitability and short-term projects.*
- *It may cause of decrease in share price.*
- *The concept of profit maximization fails to consider the fluctuations in profit earned from year to year.*
- *It fails to consider the social responsibility of business, maximization of firm's profit at the cost of society.*

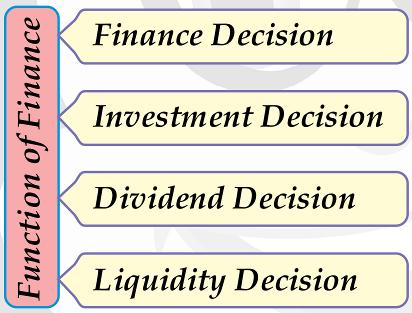
Wealth Maximization : *Wealth maximization is the risk taken and time value of money as the objective of financial management.* It is also known as ***"Value maximization or Net Present Value Maximization".*** Wealth maximization means maximizing the net wealth of a company's shareholders. In financial management, the term wealth maximization means the net present value (Wealth) should be positive.

Wealth maximization can be created if company would increase the market value of share in the market. Market price of share serves as an index of the performance of the company. The objective of maximizing economic welfare of shareholders is achieved through maximization of their wealth. In company form of business the wealth created is reflected in the market value of its share.

In modern time wealth maximization is better objective due to following reasons.

- *It takes into consideration long- run survival and growth of the firm.*
- *It considers risk and time value of money.*
- *It considers all future cash flows, dividends and earning per share.*
- *According these concept regular and consistent dividend payments to the shareholders.*
- *Shareholder always prefers wealth maximization rather than maximization of profit.*
- *The financial decisions are taken with the view to improve the capital appreciation of the share price.*

Financial Decision Making (Function of Finance)



- **Finance Decision :** A financial manager takes decision for the amount of capital required, proportion of debt and equity of capital and selection of sources of funds.
- **Investment Decision :** Decisions regarding investment in fixed or long term assets are based on the cost and benefits or returns arising from the assets. This is also called capital budgeting decisions.
- **Dividend Decision :** Dividend Decision is based on formulation of dividend policy. It is payout to shareholders.
- **Liquidity Decision :** Liquidity Decision is concern with day to day financial operation which deals with working capital management

Ques. *Which one is not an important objective of Financial Management ?*

(NTA UGC-NET June 2012 P-II)

(A) Profit Maximization *(B) Wealth Maximization*

(C) Value Maximization *(D) Maximization of social benefits*

Ans. *(D) Maximization of social benefits*

Ques. *Select the correct code regarding motives for holding inventories by firms :*

(NTA UGC-NET July 2016 P-II)

(a) Transaction motive | *(b) Environmental motive*

(c) Precautionary motive | *(d) Speculative motive*

(e) Competitive motive

(A) (a), (b), (c), (d) | *(B) (a), (b), (d), (e)*

(C) (a), (d), (e) | *(D) (a), (c), (d)*

Ans. *(D) (a), (c), (d)*